FEDERAL RESERVE

press release

For Use at 4:00 p.m. July 23, 1976

The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on June 22, 1976.

Such records for each meeting of the Committee are made available a few days after the next regularly scheduled meeting and are published in the Federal Reserve Bulletin and the Board's Annual Report. The summary descriptions of economic and financial conditions they contain are based solely on the information that was available to the Committee at the time of the meeting.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on June 22, 1976

1. Domestic policy directive

The information reviewed at this meeting suggested that growth in real output of goods and services had moderated in the second quarter from the rapid pace to which it had accelerated in the first quarter, now estimated by the Commerce Department to have been at an annual rate of 8.7 per cent. Average prices appeared to have risen more in the second quarter than the first, when the rate of advance had been relatively low. Staff projections suggested that during the second half of the year real GNP would expand at a good pace and that prices would continue to rise somewhat faster than they had in the first quarter.

The second-quarter moderation in growth of real output was attributable primarily to a considerable slowing in the rates of increase in consumer spending and business inventory investment. Retail sales, which had risen substantially in late 1975 and early 1976, were estimated to have remained about unchanged in April and to have declined somewhat in May--as a result of weakness in nondurable goods sales in both months and a downturn in sales of autos in May. However, weekly data suggested some pick-up in retail sales in late May and early June.

Industrial production, employment, and personal income all rose substantially further in May. Production gains were largest in industries that make business equipment, durable consumer goods other than autos, and materials for durable goods industries. Auto production rose only slightly further. Output of nondurable goods also increased, but growth in that area had slowed appreciably from the high rates of the summer and early fall of 1975. As in April, the rise in production was reduced somewhat by a strike in the rubber industry.

Conditions in labor markets continued to improve in May. Nonfarm payroll employment reached a level some 250,000 above its pre-recession high, and the unemployment rate declined from 7.5 to 7.3 per cent. The average length of the factory workweek rebounded to about its March level, following a decline in April that apparently had been related to holidays in the week of the survey. Personal income increased at about the average rate of other recent months.

Private housing starts, which had declined in March and April, rose somewhat in May to a little above the first-quarter average rate. The May increase was accounted for by a rise in starts of multifamily units to the highest level in nearly 2 years, although such starts were still quite low by historical standards. Residential building permits increased for both single and multifamily units. Outstanding mortgage loan commitments at savings and loan associations had advanced further in April, the latest month for which data were available.

Although nonresidential construction activity remained weak in April, new orders for nondefense capital goods increased substantially further in both April and May. A Commerce Department survey of anticipated plant and equipment expenditures, taken in late April and early May, indicated that businesses were planning to step up capital outlays in 1976 relative to 1975 somewhat more than had been suggested by a corresponding survey taken in February. The rise, however, was considerably smaller than had been implied by an intervening private survey. According to the latest Commerce Department survey, the largest increases in capital outlays were planned by electric and gas utilities and manufacturers of nondurable goods.

According to available data, capacity utilization rates in industries producing major materials were still well below earlier peaks but had risen markedly, particularly in nondurable goods industries. Comments of businessmen in the course of conversations with Reserve Bank personnel also suggested that rates of capacity use were generally high in major industries. In almost all such industries, however, capacity was regarded as adequate for at least the next 6 to 12 months.

The wholesale price index for all commodities--which had risen appreciably in April following 5 months of little change--increased moderately in May. The rise was attributable to some further increase in prices of farm and food products, following their sharp advance in April. The May index for industrial commodities was virtually unchanged, but it did not reflect subsequent price increases for steel and gasoline.

The rate of increase in consumer prices stepped up somewhat in May, as prices of food and energy items rose; earlier in the year the rise in the consumer price index had been held down by declines in such items. Apart from food and energy, average consumer prices had advanced at a relatively steady annual rate, in the neighborhood of 7 per cent, for the past year.

The index of average hourly earnings for private nonfarm production workers advanced at a faster pace in May than in previous months of the year, reflecting in part the impact of a major labor settlement in the transportation industry and sizable wage increases in service industries. Over the first 5 months of 1976 the rate of increase in average wage rates was less than in the second half of 1975.

A staff analysis of the economic situation indicated that the economic expansion had slowed somewhat more in the second quarter than had been anticipated a month earlier, mainly because of sluggishness in retail sales. In the staff's judgment, however, the recent weakness in consumer spending was likely to prove to be a temporary pause of the kind that had often occurred during periods of economic expansion--most recently in 1975, following the sharp advance of the spring and early summer. It was noted that the basic determinants of consumer spending--including the rates of growth in employment and in real personal income--were conducive to a resumption relatively soon of stronger gains in outlays.

In general, it appeared that there had been little change during the past month in the fundamental factors underlying the outlook for economic activity. Therefore, relatively little change had been made in the staff's projections for the second half of 1976. Although the latest Commerce Department survey suggested less growth in business capital spending than had an earlier private survey, the outlook in that sector remained relatively favorable--in light of such factors as the recent increases in production of business equipment and in new orders for nondefense capital goods, and rising rates of capacity utilization. Businesses were expected to maintain a high rate of inventory investment, particularly in durable goods. Residential construction outlays were projected to rise in the second half, although at a somewhat slower pace than anticipated a month earlier.

U.S. foreign trade was in deficit again during April, but the deficit was less than in March and was about equal to the average rate in the first quarter. Nonfuel imports declined from their high March volume, while nonagricultural exports rose somewhat from the depressed levels early in the year.

In the latter part of May the average value of the dollar against leading foreign currencies increased about 1 per cent on a trade-weighted basis, in part because of a rise in U.S. interest rates relative to interest rates abroad, but it changed little thereafter. During the period since the meeting of the Committee in mid-May the dollar had appreciated on balance against all major currencies except the Canadian dollar and the Swiss franc. A steep decline in exchange rates for the British pound was halted and partly reversed in early June after announcement of a $5.3 billion package of standby credits to the Bank of England by the Group of Ten countries, Switzerland, and the Bank for International Settlements. The package included $1 billion under the Federal Reserve swap line with the Bank of England and $1 billion under a U.S. Treasury Exchange Stabilization Fund swap arrangement with that Bank.

At U.S. commercial banks total loans and investments expanded further in May, but most of the growth continued to reflect increased bank holdings of Treasury securities. While real estate loans remained strong and business loans rose for the first time since January, total loans outstanding at banks were about unchanged. The volume of commercial paper issued by nonfinancial corporations increased somewhat further during the month.

Growth in the narrowly defined money stock--M_1--slowed to a 6 per cent annual rate in May from the exceptionally rapid 15 per cent rate recorded in April and appeared to be moderating further in early June. Much of the slowing might have been attributable to adjustments in cash balances following the bulge that had developed in April. Growth in the broader measures of the money stock--M_2 and M_3--also slowed in May, due in most part to the slower expansion in demand deposits. Inflows of time and savings deposits (other than negotiable CD's) at banks and nonbank thrift institutions were relatively well maintained during May and early June--despite a marked diminution of inflows to passbook savings accounts at banks as short-term market interest rates moved above the ceiling rate on such accounts.

System open market operations since the May meeting had been guided by the Committee's decision to seek bank reserve and money market conditions consistent with moderate growth in the monetary aggregates over the period ahead, while taking account of developments in domestic and international financial markets.

Immediately following the May meeting, the System had become a little less accommodative in the provision of reserves, as it aimed at reserve conditions consistent with a Federal funds rate averaging around 5-3/8 per cent. This was slightly above the 5-1/4 per cent rate prevailing at the time of the meeting and equal to the midpoint of the 5 to 5-3/4 per cent operating range that the Committee had specified for the inter-meeting period.

Data becoming available in the latter part of May suggested that the May-June rates of growth in both M_1 and M_2 would be near the upper ends of the Committee's ranges of tolerance. Accordingly, the System sought reserve conditions consistent with a Federal funds rate of about 5-1/2 per cent. While subsequent data tended to confirm the late-May projection of growth in M_2, they also suggested that growth in M_1 might be weaker than had been indicated earlier. Under the circumstances the System continued to aim at reserve conditions consistent with a Federal funds rate averaging around 5-1/2 per cent.

Short-term interest rates in general rose somewhat further in the latter part of May, reflecting market responses to the firming in money market conditions and some increase in business credit demands. During this period most banks raised the prime rate applicable to large business borrowers in two steps from

6-3/4 to 7-1/4 per cent. Subsequently, short-term rates fluctuated in a narrow range, as market attitudes appeared to be influenced by indications that the rate of monetary growth had slowed, by the leveling off of the Federal funds rate, and by evidence of some moderation in the pace of economic expansion. Over the inter-meeting period as a whole, most private short-term interest rates increased modestly, on balance, while rates on Treasury securities changed little. On the day before this meeting the market rate on 3-month Treasury bills was 5.36 per cent, compared with 5.22 per cent on the day before the May meeting.

Interest rates on intermediate- and long-term securities declined a little on balance over the inter-meeting period, in part reflecting the stabilization of conditions in short-term markets. In May public offerings of new corporate bonds and stocks remained substantial, and the volume of new State and local government bond offerings rose to the highest level on record.

Interest rates on home mortgages in the primary market, which typically lag bond yields, had edged up in recent weeks. However, yields in the secondary market for mortgages tended to move with other long-term rates--rising in May and declining in the first half of June.

In mid-May the Treasury announced plans to sell \$2.25 billion of 2-year notes and \$2.0 billion of 4-year 1-month notes, in order to refund \$1.5 billion of publicly held notes maturing on May 31 and to raise \$2.75 billion of new cash. In auctions on May 19 and June 3 the notes were sold at average prices to yield 7.16 and 7.71 per cent, respectively. Because its cash balance exceeded its earlier anticipations, the Treasury was able to meet its seasonal financing need prior to the June 15 tax date through the issuance of \$2 billion of 9-day cash-management bills--roughly half the amount previously projected. In the week before this meeting the Treasury announced that in the coming weeks it would sell \$2.5 billion of 2-year notes and \$2.5 billion of 5-year 1-month notes.

In April, when the Committee had last reviewed its longer-run ranges for the monetary aggregates, it had agreed that on the average over the period from the first quarter of 1976 to the first quarter of 1977 growth at rates within the following ranges appeared to be consistent with its broad economic aims: M_1, 4-1/2 to 7 per cent; M_2, 7-1/2 to 10 per cent; and M_3, 9 to 12 per cent. The associated range for growth in the bank credit proxy was 6 to 9 per cent. It was agreed that the longer-term ranges, as well as the particular list of aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings. It was also understood that, as a result of short-run factors, growth rates from month to month might well fall outside the ranges contemplated for annual periods.

In the discussion of current policy at this meeting, the Committee took note of a staff analysis suggesting that, if prevailing money market conditions were maintained over the coming 4-week interval, rates of growth in M_1 and M_2 for June and July combined were likely to average close to the moderate pace that had developed in May. These rates were substantially below the very rapid growth rates experienced in April and near the midpoints of the longer-run ranges agreed upon by the Committee at its April meeting.

The staff analysis suggested that growth in M_1 would be influenced by increasing demands for money associated with expansion in nominal GNP, but that the rise in June was likely to be somewhat smaller than in July because of continuing adjustments of cash balances built up during the April bulge in money growth. Growth in the time deposit component of M_2 was expected to moderate slightly further, reflecting some continued shifts of interest-sensitive funds from passbook savings accounts to alternative forms of liquid assets.

The analysis also suggested that financial markets were not likely to come under pressure in the near term. Following the large volume of new corporate and municipal issues being offered in June, the supply of new bonds was expected to slacken seasonally. Moreover, while the Treasury faced a large budget deficit in the third quarter, it appeared that part of its cash needs in that quarter could be accommodated through reductions in what seemed likely to be a relatively large mid-year cash balance. It appeared, however, that over the somewhat longer run, strengthening could be expected in private short-term credit demands, particularly from businesses.

In discussion of the longer-term outlook for credit demands, it was noted by a staff member that business inventory accumulation and capital spending were projected to be larger in the second half of 1976 than in the first half. Because these expanded outlays seemed likely to exceed internal accumulations of funds, over-all business needs for external financing were projected to rise. In view of the large volume of financing already accommodated in capital markets during the first half of the year, the bulk of this additional second-half need was expected to be met at banks.

During the Committee's policy discussion, it was observed that the apparent moderation in the rate of growth in real GNP in the second quarter was, by and large, a healthy development, in the sense that continuation of the rapid first-quarter rate of expansion would soon have generated undesirable boom conditions. On the whole, the members were of the view that the economic expansion was proceeding satisfactorily and that the outlook was favorable. At the same time, some concern was expressed about the possibility that inflationary pressures would strengthen as the expansion proceeded.

Some differences emerged during the discussion in the degree of confidence with which members viewed the outlook in particular economic sectors. Thus, while the members were generally inclined to agree that the second-quarter slowing in consumer spending--which had been a major contributing factor to the moderation in GNP growth--was likely to prove temporary, several noted that that outcome was not wholly certain. Some members were more confident than others about the likely strength in capital spending. One member, who was personally optimistic on that score, nevertheless observed that the investment plans of many of the businessmen with whom he had talked were being affected by their concerns regarding the implications of current and possible governmental regulatory actions. Another indicated that he would interpret recent businessmen's comments to Reserve Banks as suggesting that there was less excess capacity in the economy than one might have thought. With respect to the outlook for residential construction, some members indicated that they had been rather disappointed by developments in recent months--including the relatively low average rate of multifamily starts and the failure of new home sales to rise above the levels of last autumn. In support of a contrary view, reference was made to the May increase in starts and permits, and to what appeared to be a generally optimistic attitude within the homebuilding industry.

In general, Committee members favored directing open market operations in the period immediately ahead toward achieving bank reserve and money market conditions consistent with moderate growth in the monetary aggregates. Some suggested specifying operating ranges for M_1 and M_2 in the June-July period with upper limits no higher than 7 and 10 per cent, respectively--the upper limits of the longer-run ranges agreed upon at the April meeting--on the ground that more rapid growth in the short run would make realization of the longer-run goals more difficult. Others indicated that they were prepared to accept somewhat more rapid growth over the June-July period.

The Committee agreed that it would be desirable to maintain relative stability in money market conditions at this juncture, in light of the current slowing of the economic expansion and the moderation of growth in the monetary aggregates since April. It was noted by some members that, if the economy expanded about as projected during the second half of the year, some firming of money market conditions might well be required to hold growth of the monetary aggregates within the Committee's longer-run ranges, and it was suggested that a small rise in the Federal funds rate now might serve to moderate the extent of the increase that might otherwise be indicated later. It was also noted, however, that there was little risk in awaiting stronger confirmation that the recent slowing of growth in consumer spending was only temporary. In addition, it was observed that short-term interest rates were already somewhat higher than they had been in April. With respect to the interest rate outlook, one Committee member questioned the staff's projection of enlarged business credit demands at banks in the second half of 1976.

There were some differences in members' views regarding the desired inter-meeting range of tolerance for the weekly-average Federal funds rate. A substantial majority favored a relatively narrow range of 5-1/4 to 5-3/4 per cent, on the grounds that a significant easing of money market conditions would be undesirable at this time in view of the likelihood that it might have to be reversed shortly, and that a significant firming would be inappropriate in view of the element of uncertainty in the economic outlook. Some, however, preferred a wider range of 5 to 6 per cent in order to allow more scope for responses to possible deviations from expectations in growth rates of the monetary aggregates.

At the conclusion of the discussion the Committee members agreed that growth in M_1 and M_2 over the June-July period at annual rates of 3-1/2 to 7-1/2 per cent and 6 to 10 per cent, respectively, would be acceptable. As at other recent meetings, they decided that approximately equal weight should be given to M_1 and M_2 in assessing the behavior of the aggregates. Finally, they agreed that until the next meeting the weekly-average Federal funds rate might be expected to vary in a gradual and orderly way within a 5-1/4 to 5-3/4 per cent range. As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that growth in real output of goods and services, which had been vigorous in the first quarter, has moderated in the current quarter. In May retail sales declined from the March-April level and were near the monthly average of the first quarter. However, recovery in industrial production continued at about the average pace of the first 4 months of the year, and the gain in employment again was substantial. The unemployment rate declined from 7.5 to 7.3 per cent. The rise in the wholesale price index for all commodities, which had been large in April, was moderate in May; average prices of farm products and foods rose much less than in April. Average prices of industrial commodities changed little in May, but in recent weeks price increases have been announced for some major industrial materials. The rise in consumer prices in May was somewhat faster than the average increase in earlier months of the year, owing to increases in prices of food and energy items. The advance in the index of average wage rates was larger in May than the gains in other recent months, owing in part to implementation of a new labor contract in a major industry.

The average value of the dollar against leading foreign currencies has been relatively steady in recent weeks. On June 7 a total of $5.3 billion of 6-month stand-by credits to the United Kingdom was announced, including $1 billion under the Federal Reserve System's swap line and $1 billion from the Exchange Stabilization Fund. Subsequently, the decline in the pound sterling was halted and partly reversed. In April the U.S. foreign trade deficit was at the same rate as in the first quarter.

Growth in monetary aggregates slowed substantially in May and early June from the exceptionally rapid rates recorded in April, mainly because of a sharp slackening in expansion of demand deposits at commercial banks; inflows of those time and savings deposits included in the broader aggregates were relatively well maintained. Market interest rates in general rose somewhat further in the latter part of May, but since then, short-term rates have fluctuated in a narrow range and long-term rates have edged down.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions that will encourage continued economic expansion, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead.

Votes for this action: Messrs. Burns, Volcker, Balles, Black, Coldwell, Gardner, Jackson, Lilly, Partee, Wallich, Winn, and Baughman. Votes against this action: None. Absent and not voting: Mr. Kimbrel. (Mr. Baughman voted as alternate for Mr. Kimbrel.)